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Supreme Court of the United States

OCTOBER TERM, 1998
No. 98-1595

GEORGE LAWRENCE FITZGERALD,
Petitioner,

--V.--

KENNETH S. APFEL, COMMISSIONER
OF SOCIAL SECURITY,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR
THE FOURTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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9188

QUESTION PRESENTED

I. MAY THE COMMISSIONER OF SOCIAL SECURITY ALLOCATE A CORPORATION'S UNDISTRIBUTED TAXABLE INCOME TO A MAJOR STOCKHOLDER WHO PERFORMS SUBSTANTIAL SERVICES FOR SUCH CORPORATION, AS EXCESS EARNINGS FOR PURPOSES OF OLD AGE INSURANCE BENEFITS .
(42 U.S.C.A. 403 (f)(4)(B))

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d. All are unpublished.

e. (i) November 13, 1998

(iv) The statutory provision believed to confer on this Court jurisdiction to review the judgment in question by writ of certiorari is 28 U.S.C. 1254 (1).

f. 42 U.S.C. 402 (a) "(a) Old-Age Insurance Benefits

Every individual who-

(1) is a fully insured individual (as defined in Section 214 (a)),

(2) has attained age 62, and,

(3) has filed application for old-age insurance benefits or was entitled to disability insurance

benefits for the month preceding the month in which he attained retirement age (as defined in Section 416(1), shall be entitled to an old-age insurance benefit for each month."

42 U.S.C. 403 (f) (4) "(B) An individual will be presumed, with respect to any month, to have rendered services for wage (determined as provided in paragraph (5)) of more than the applicable exempt amount as determined under paragraph (8) until it is shown to the satisfaction of the Commissioner of Social Security that such individual did not render such services in such month for more than such amount.

(5)(A) An individual's earnings for a taxable year shall be (i) the sum of his wages for services rendered in such year and his net earnings from self-employment for such a year, minus (ii) any net loss from self-employment for such year."

42 U.S.C. 403 (f)(8) "(D) Notwithstanding any

other provision of this subsection, the exempt amount which is applicable to an individual who has attained retirement age (as defined in Section 216 (l)) before the close of the taxable year involved shall be--

(i) for each month of any taxable year ending after 1991 and before 1993, $850.00,

(ii) for each month of any taxable year ending after 1992 and before 1994, $880.00,

(iii) for each month of any taxable year ending after 1993 and before 1995, $930.00,

(iv) for each month of any taxable year ending after 1994 and before 1996, $940.00,

(v) for each month of any taxable year ending after 1995 and before 1997, $1,041.66."

42 U.S.C. 411 " For the purposes of this title-- (a) ***Net earnings from Self Employment***

The term "net earnings from self-employment" means the gross income, as computed under subtitle A of the Internal Revenue Code of 1986, derived by an individual from any trade or business carried on by such individual, less the deductions allowed under such subtitle which are attributable to such trade or business, ...

(1) There shall be excluded rentals from real estate and from personal property leased with the real estate...

(2) There shall be excluded dividends on any share of stock, and interest on any bond, debenture, note, or certificate, or other evidence of indebtedness, issued with interest coupons or in registered form by any corporation (including one issued by a government or political subdivision thereof), unless

such dividends and interest are received in the course of a trade or business as a dealer in stocks or securities;"

(g) Plaintiff petitions for a writ of certiorari from a decision of the Fourth Circuit Court of Appeals affirming an Order of the U.S. District Court adopting a M & R of a Magistrate Judge granting Summary Judgment to the Commissioner of Social Security in Plaintiff's civil action for Social Security old age insurance benefits.

George L. Fitzgerald, born July 8, 1926, attained the age of 65 in 1991.

He is a licensed attorney who has practiced law in Charlotte, NC since 1955.

In May 1991, Fitzgerald applied for Social Security old age insurance benefits. Although found eligible, no benefits were paid on the ground that although wages paid to Fitzgerald by his employer George L. Fitzgerald, P.C. (Professional Corporation) did not constitute "excess earnings", the Professional Corporation employing Fitzgerald, who was its sole stockholder had funds at its disposal which could have been paid to Fitzgerald and if such funds has in fact been paid, Fitzgerald would have received "excess earnings" which would prevent him from receiving Social Security old age insurance benefits. The Fourth Circuit Court of Appeals approved this administrative procedure by piercing the corporate veil.

Although Social Security persists in referring to the Social Security old age insurance benefits as "retirement benefits" this is a misnomer. (See 42 U.S.C. 402 (a)). This is an "excess earnings" test and a covered worker need not be "retired" except during the year in which he attains age 65 [or age 62] which is known as the "grace year".

(ii) The action was originally brought pursuant to Sec. 205 (g) of the Social Security Act, 42 U.S.C. 405 (g) for judicial review of a final administrative decision of the Commissioner of Social Security denying an application for Social Security old age insurance benefits.

(h) The reason relied on for issuance of the Writ is that the decision of the Fourth Circuit Court of Appeals piercing the corporate veil and charging plaintiff with "excess earnings" is in

conflict with decisions of the Sixth, Eighth, Tenth and Eleventh Circuits.

The issue in this case is whether the old age insurance benefits can be paid at their full rate or at a reduced rate.

The four above named Circuit Courts of Appeal have refused to "pierce the corporate veil" and charge the party seeking old age insurance benefits with additional countable earnings except when the wage earner attempted to evade the "excess earnings" test by reducing his own earnings and raising the salary of a spouse or family member or raising dividends in lieu of salary so he could evade the "excess earnings" test. That is not the situation in this case.

In a Tenth Circuit case the Court said:

"We find no authority whatever which would empower the Secretary of Health, Education and Welfare to allocate a portion of the corporation's undistributed profit and income to Mr. Hall as remuneration for his services. The Commissioner of Internal Revenue has authority to make some reallocation for tax purposes among family members shareholders, but this certainly does not give the Secretary of Health, Education and Welfare such authority."

Gardner v. Hall, 366 F. 2d 132 (10th Cir. 1966)

In an Eighth Circuit case the Court said:

> "...the Commissioner determined that John Johnson, Sr. was underpaid, that is, that his services were worth $16,800,

or $9,800 more than he was paid in 1991. Even though Cowhill Farms apparently had the corporate funds available to make such a payment, there is no evidence in this record that such funds (in excess of the reported $7,000) were actually paid or distributed to John Johnson, Sr. We hold the Commissioner cannot, for Social Security purposes, allocate a portion of undistributed corporate profits to John Johnson, Sr., as remuneration for his services for social security purposes."

Johnson v. Chater, 127 F. 3rd 756 (8th Cir. 1997).

Heer v. HHS, 670 F. 2d 653

(6th Cir. 1982) and Martin v. Sullivan,

894 F. 2d 1520 (11th Cir. 1990)

are in accord.

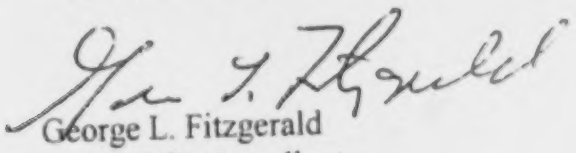
The instant Fourth Circuit Court of

Appeals case stands alone in opposition

to the decisions of four Circuits.

This the 26th day of March,1999.

Respetfully Submitted,



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APPENDIX

UNPUBLISHED

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

GEORGE LAWRENCE FITZGERALD,
Plaintiff-Appellant,

v.

KENNETH S. APFEL, COMMISSIONER OF SOCIAL SECURITY,
Defendant-Appellee.

No. 98-1218

Appeal from the United States District Court
for the Western District of North Carolina, at Charlotte.
Graham C. Mullen, District Judge.
(CA-96-525-MU)

Submitted: October 20, 1998

Decided: November 13, 1998

Before NIEMEYER, LUTTIG, and MICHAEL, Circuit Judges.

Affirmed by unpublished per curiam opinion.

COUNSEL

George L. Fitzgerald, Charlotte, North Carolina, for Appellant. Mark T. Calloway, United States Attorney, Joseph L. Brinkley, Assistant United States Attorney, Charlotte, North Carolina, for Appellee.

Unpublished opinions are not binding precedent in this circuit. See Local Rule 36(c).

OPINION

PER CURIAM:

George L. Fitzgerald appeals from the district court's order adopting the report and recommendation of a magistrate judge and granting summary judgment to the Commissioner of Social Security ("Commissioner") in Fitzgerald's civil action for retirement benefits. Because substantial evidence supports the denial of benefits, we affirm.

Fitzgerald, born July 8, 1926, attained the age of 65 in 1991. He is a licensed attorney who has been engaged in the practice of law in North Carolina since 1955. In May 1991, Fitzgerald applied for retirement benefits. Although found eligible, no benefits were paid because Fitzgerald's continued employment resulted in excess earnings.

In September 1991, Fitzgerald incorporated his solo law practice, designating himself as the corporation's president, treasurer and sole shareholder and legal assistant as secretary. On November 5, 1991, Fitzgerald informed the Social Security Administration ("SSA") that he wanted his retirement checks to be issued monthly starting in January 1992, because his income for that year from his self-employment would be less than the $8840 limit.

Fitzgerald began doing business under this new corporate structure on January 1, 1992, and reported the corporation's existence to the SSA in February 1992, indicating that no other attorneys were employed by the corporation and that he would continue doing all of the work for a salary of $850 a month. Corporate tax returns established that the corporation grossed $202,507 in 1992 and $213,264 in 1993. The SSA informed Fitzgerald that for earnings test purposes, he would be charged with his salary plus the ordinary income of his corporation. On Fitzgerald's request for reconsideration, the SSA upheld its initial determination denying benefits.

During the requested administrative hearing, Fitzgerald testified that he incorporated his law practice after his 65th birthday and set his salary below the allowed income limit in order to receive social

security retirement benefits. Accordingly, the amount of his salary bears no relation to the value of his services. Fitzgerald further testified that although currently able to declare corporate dividends, he intends not to distribute any dividends, but to retain all profits and pay out the lump sum upon attaining his 71st birthday. After the hearing, the ALJ determined that Fitzgerald was not entitled to retirement benefits. Though the Appeals Council granted Fitzgerald's petition for review, it determined that Fitzgerald had no right to a hearing before an ALJ because the suspension of benefits is not an initial determination that is subject to the administrative review process.

Subsequently, the SSA informed Fitzgerald that he had excess earnings for 1992, 1993, and 1994. This determination was upheld on reconsideration. On December 13, 1995, the ALJ found that Fitzgerald was not entitled to retirement benefits based on the amount of his earnings. The Appeals Council denied Fitzgerald's request for review, and the ALJ's decision became the final decision of the Commissioner. Fitzgerald then filed a civil action in the district court. Both Fitzgerald and the Commissioner filed summary judgment motions. The district court accepted the magistrate judge's recommendation and granted the Commissioner's motion for summary judgment on the basis that substantial evidence supported the Commissioner's decision to deny benefits.

On appeal, Fitzgerald contends that the Commissioner lacked authority to reallocate undistributed corporate profits as his personal wages for the purpose of computing excess earnings under 42 U.S.C.A. § 403 (West Supp. 1998), relying on *Taubenfeld v. Bowen*, 685 F. Supp. 237, 240-41 (S.D. Fla. 1988). We disagree.

We review the Commissioner's final decision to determine whether it is supported by substantial evidence and whether the correct law was applied.[1] Substantial evidence is "'such relevant evidence as a reasonable mind might accept as adequate to support a conclusion.'"[2] As the presiding officer at the administrative hearing, the ALJ makes

[1] *See* 42 U.S.C.A. § 405(g) (West Supp. 1998); *Hays v. Sullivan*, 907 F.2d 1453, 1456 (4th Cir. 1990).

[2] *Richardson v. Perales*, 402 U.S. 389, 401 (1971) (quoting *Consolidated Edison Co. v. NLRB*, 305 U.S. 197, 229 (1938)).

factual determinations and resolves evidentiary conflicts. We, as the reviewing court, do not re-weigh evidence, make credibility determinations, or substitute our judgment for that of the Commissioner.[3]

Qualified applicants who are eligible for retirement benefits are not allowed to work or engage in self-employment that results in a yearly income that exceeds a specified amount.[4] The applicant has the burden of rebutting the presumption of excess earnings.[5] The Commissioner has the authority to examine the substance of business transactions rather than its form and has the duty to pierce any fictitious arrangements designed to shift salary payments.[6] The Commissioner's determination of an applicant's earnings "must be related to the reality of his connection with the labor market and cannot be based on paper allocation of income."[7]

We find that substantial evidence supports the Commissioner's decision and that the ALJ applied the correct law. Fitzgerald had not retired from the practice of law nor had he relinquished any of the major managerial responsibilities of the corporation.[8] There was no decrease in his work activities. He worked the same number of hours, earning the same rate of income for himself and the corporation while drawing a disproportionately small salary that bore no relation to his connection with the labor market.[9] He hired no other attorney to take

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[3]*See Smith v. Chater*, 99 F.3d 635, 638 (4th Cir. 1996); *Hays*, 907 F.2d at 1456.

[4]*See* 42 U.S.C.A. §§ 402(a), 403(f) (West Supp. 1998).

[5]*See Johnson v. Chater*, 127 F.3d 756, 758-59 (8th Cir. 1997) (citing *Martin v. Sullivan*, 894 F.2d 1520, 1531-32 (11th Cir. 1990)).

[6]*See Heer v. Secretary of Health & Human Servs.*, 670 F.2d 653, 655 (6th Cir. 1982).

[7]*Martin*, 894 F.2d at 1534.

[8]*See Perez v. Secretary of Health, Educ. & Welfare*, 353 F. Supp. 1282 (D.P.R. 1972) (outlining criteria to determine if retirement has occurred, which include amount of work actually performed after retirement and whether another employee was hired to perform work no longer done by retiree).

[9]Fitzgerald admitted that his salary was structured below the allowable earnings to maximize his eligibility for retirement benefits.

on any additional responsibilities. He retained complete decision-making authority of the corporation as its president, treasurer, and sole shareholder. Thus, we find sufficient evidence supports the Commissioner's determination that Fitzgerald had not retired and was therefore not entitled to retirement benefits.

Fitzgerald's reliance on *Taubenfeld* is misplaced. In *Taubenfeld*, while the duties of other family members within the retail clothing corporation increased, the applicant curtailed his work hours, reduced his salary, and resigned as president of the corporation.[10] The court found that although Taubenfeld was retired, he continued to contribute substantial services to the corporation. Yet, the corporation's undistributed earnings could not be allocated to its retired president because there was no evidence that the corporation was other than bona fide; there was no intermingling of corporate and personal funds, nor did Taubenfeld endeavor to run the corporation as a sole proprietorship.[11]

We cannot, however, reach a similar conclusion in this appeal. Fitzgerald was not retired. He continued to contribute substantial services to the corporation and ran the business as if it were a sole proprietorship. Although there was no evidence of commingled funds, we find sufficient evidence supports the Commissioner's determination that Fitzgerald's corporation was not bona fide. Accordingly, the Commissioner's decision to pierce this fictitious salary arrangement and allocate the corporate earnings to Fitzgerald personally was also supported by substantial evidence.

We therefore affirm the district court's order granting the Commissioner's summary judgment motion. We dispense with oral argument because the facts and legal contentions are adequately presented in the materials before the court and argument would not aid the decisional process.

AFFIRMED

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[10]*See Taubenfeld*, 685 F. Supp. at 239.

[11]*See Taubenfeld*, 685 F. Supp. at 240.

FILED
CHARLOTTE, NC
JAN. 13, 1998
U.S. DISTRICT COURT
W. DIST. OF N.C.

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF NORTH CAROLINA
CHARLOTTE DIVISION

George L. Fitzgerald,

Plaintiff(s), JUDGMENT IN A CIVIL CASE

vs.

3:96-cv-525-MU

JOHN J. CALLAHAN, Commissioner of
Social Security,

Defendant(s),

DECISION BY COURT. This action having come before the Court and a decision has been rendered.

IT IS ORDERED AND ADJUDGED that judgment is hereby entered in accordance with the Court's 1/12/98 Order.

January 13, 1998 FRANK G. JOHNS, CLERK

By: Frank G. Johns

FILED
CHARLOTTE, N.C.
JAN 12, 1998
U.S. DISTRICT COURT
W. DIST. OF N.C.

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF NORTH CAROLINA
CHARLOTTE DIVISION
3:96CV525-MU

GEORGE L. FITZGERALD, Plaintiff	)
vs.	) ORDER
JOHN J. CALLAHAN, COMMISSIONER OF SOCIAL SECURITY, Defendant	)

This matter is before the Court upon the Memorandum and Recommendation of United States Magistrate H. Brent McKnight, filed October 14, 1997.

After an independent and thorough review of the

magistrate's memorandum, plaintiff's objections thereto, and a de novo review of the record, the Court concludes that the recommendation to deny plaintiff's motion for summary judgment and to grant the defendant's motion for summary judgment is correct and in accordance with law.

IT IS THEREFORE ORDERED that the Memorandum and Recommendation of the magistrate is hereby AFFIRMED.

This 12th day of January, 1998.

Graham C. Mullen
Graham C. Mullen
United States District Judge

FILED
CHARLOTTE, N.C.
OCT 14, 1997
U.S. DISTRICT COURT
W. DIST. OF N.C.

IN THE DISTRICT COURT OF THE UNITED STATES
FOR THE WESTERN DISTRICT OF NORTH CAROLINA
CHARLOTTE DIVISION
3:96CV525-MU

GEORGE L. FITZGERALD, Plaintiff	)
v.	) MEMORANDUM &) RECOMMENDATION
JOHN J. CALLAHAN, COMMISSIONER OF SOCIAL SECURITY, Defendant	)

THIS MATTER is before the undersigned Magistrate Judge on reference from the District Court pursuant to 28 U.S.C. Sec. 636 (B) (1) (B).

CLAIM FOR RELIEF

In this Social Security retirement insurance case, Plaintiff has filed a Motion for Summary Judgment and supporting brief (Doc.2) and the Commissioner has responded with its own Motion for Summary Judgment and supporting brief (docs. 12, 13). Having fully considered the written arguments, the administrative record, and the applicable authorities, the undersigned finds that the Secretary's decision is supported by substantial evidence and should be affirmed.

I. **Factual and Procedural Background**

Plaintiff is an attorney licensed to practice law in North Carolina. He was born on July 8, 1926, and attained age 65 in 1991.

Through August 1991, Plaintiff operated his law practice as a sole proprietorship, primarily representing social security claimants. In

September 1991, Plaintiff incorporated his law practice as George L. Fitzgerald P.C. (Tr. 39.) Plaintiff is the president, treasurer, sole-attorney employee, sole shareholder, and sole member of the board of directors. (Tr. 39.) Lynda Outen is the corporation's secretary. (Tr. 39.) Since becoming incorporated, Plaintiff has not reduced his hours of work, although he has decreased his salary considerably.

Plaintiff filed an application for retirement insurance benefits with the Social Security Administration (the "Administration") in May 1991. (Tr. 32-34.) In response to his application, the Administration notified Plaintiff that although he was eligible for retirement benefits, no benefits were payable to him because he continued work. (Tr. 35-36.) Plaintiff then sent a letter to the Administration stating that he wanted his retirement

checks to start in January 1992 because his business had become incorporated and his salary in 1992 would be less than the $8, 840.00 limit. (Tr. 38.)

In March 1992, the Administration informed Plaintiff that for earnings test purposes, Plaintiff would be charged with his salary plus the ordinary income of the corporation. (Tr. 41-42) Plaintiff objected to this determination, and upon Plaintiff's request, a hearing was held before an administrative law judge ("ALJ"). (Tr. 161.) On November 23, 1992, the ALJ rendered a decision, concluding that the corporation was Plaintiff's "alter ego," and, therefore, the corporation's net earnings should be attributed to Plaintiff for purposes of the earnings test. (Tr. 98-102)

Plaintiff subsequently received notices dated October 31, 1994 and November 7, 1994, informing him that because he had excess earnings for 1992, 1993 and 1994, he was entitled to no

retirement benefits for those years. (Tr. 110-113) Although Plaintiff requested a reconsideration of those determinations, the initial determinations were upheld on appeal. (Tr. 118-122)

In March 1995, Plaintiff requested a hearing before an ALJ, (Tr. 125), but subsequently waived his right to a hearing since a complete hearing had already been held on the matter. (Tr. 24) On December 13, 1995, the ALJ rendered a decision finding, once again, that for earnings test purposes, Plaintiff's earnings consisted of both his salary and the net income of the corporation. (Tr. 21) Since Plaintiff's monthly earnings exceeded the monthly exempt amount, the ALJ concluded that Plaintiff was not entitled to retirement insurance benefits. (Tr. 21) The ALJ's decision became the final decision of the Commissioner when the Appeals Council concluded that there was no basis under pertinent regulations for

granting Plaintiff's request for a review of the ALJ's decision. (Tr. 3)

On December 11, 1996, Plaintiff filed this lawsuit against the Commissioner, seeking an award of social security benefits from January 1, 1992 through July 1996 (Doc. 1.) Plaintiff alleges that the Commissioner may not allocate a corporation's undistributed taxable income to a major stockholder who performs substantial services for such corporation, as excess earnings.

II. **Standard of Review**

The scope of this court's review is limited. "[T]he findings of the Secretary s to any fact, if supported by substantial evidence, shall be conclusive. . . ." 42 U.S.C. Sec. 405 (g). Review by this court is not de novo; rather, factual findings are left to the secretary and the undersigned's duty is to determine whether such findings were

supported by substantial evidence. King v. Califano, 599 F. 2d 597, 599 (4th Cir. 1979). Substantial evidence is "more than a mere scintilla of evidence, but. . .somewhat less than a preponderance." Laws v. Celebrezze, 368 F. 2d 640, 642 (4th Cir. 1966). When supported by substantial evidence, the Secretary's decision must be affirmed even if the court would otherwise be inclined to find that "the evidence preponderates toward a wholly different finding." Oldham v. Schweiker, 660 F 2d 1078, 1083 (5th Cir. 1981). Substantial evidence is defined as such relevant evidence as a reasonable mind might accept as adequate to support a conclusion and must be sufficient to justify a refusal to direct a verdict were the case before a jury. Id.

III. **Analysis**

Claimants age 62 or over who have worked the required number of quarters and who make application to the

Administration are eligible to receive old-age benefits 42 U.S.C. Sec. 402 (a). Deductions are made however, when a claimant earns more than a specified exempt amount 42 U.S.C. Sec. 403 (b). Earnings beyond this exempt threshold are referred to as excess earnings. There is a statutory presumption that a claimant has rendered services for wages in excess of the exempt amount and has rendered substantial services to his or her business until he or she proves otherwise to the satisfaction of the Secretary. 42 U.S.C. Sec. 403 (f) (4).

In the present case, it is undisputed that the salary Plaintiff received from the corporation was less than the exempt amount for each of the years in question. Notwithstanding this fact, the ALJ determined that the net income of the corporation should be attributed to Plaintiff for earnings test purposes. The ALJ reasoned that the corporation's "veil" should be "pierced" because

the corporation was a "sham legal structure" and the "alter ego" of plaintiff. (Tr. 20) Since plaintiff's salary and the net income of the corporation exceeded the exempt amount for the years in question, the ALJ determined Plaintiff was not entitled to retirement benefits.

In this lawsuit, Plaintiff argues the ALJ erred in ignoring the corporation's existence and charging the net income of the corporation to Plaintiff as excess earnings. Because the corporation was legally formed and because Plaintiff did not commingle his personal funds with those of the corporation, Plaintiff asserts that the corporation's retained earnings cannot be charged to him as excess earnings.

It is well settled that the Secretary has the power to examine the power over the form of business transactions and

relationships for purposes of the Social Security Act. Heer v. Secretary of Health & Human Services, 670 F. 2d 653, 655 (6th Cir. 1982). The Eighth Circuit has stated that:

we think it is the intendment of the Social Security Act that the Secretary has authority to determine what constitutes wages under the Social Security Act, and that this authorization is essential to the Secretary in carrying out his duties under the Social Security Act, and in particular Sec. 403 (b) and related sections. It would appear that he has the authority to consider substance over form and to evaluate the realities of a transaction, and unless there is some specific legal prohibition against his actions or an abuse of discretion, his decision should stand.

Ludeking v. Finch, 421 F. 2d 499, 502 (8th Cir. 1970).

Notwithstanding these authorities, Plaintiff contends that

case law specifically prohibits the Secretary from ignoring a corporations's existence and allocating undistributed corporate profits to a shareholder as excess earnings. It is true that a number of courts have found that the Secretary erroneously attributed undistributed corporate profits to a claimant as excess earnngs. See e.g., Gonzalez v. Heckler, 1985 WL 71804 (S.D. Fla. 1985); Letz v. Weinberger, 401 F. Supp. 598 (D. Col.1975); Gardner v. Hall, 254 F. Supp. 35 (E.D. Va. 1966). However, each of the above cases is distinguishable from the instant case.

In the present case, unlike the cases cited by Plaintiff, the ALJ found that the corporation was really a sham. The ALJ determined that Plaintiff formed the Corporation for the sole purpose of entitling Plaintiff to retirement benefits, and the corporation was the "alter ego" of Plaintiff. Because the

corporation was determined to be a sham, the ALJ concluded that the corporate veil should be pierced and the corporation's undistributed profits attributed to Plaintiff as excess earnings. North Carolina law permits the corporate veil to be pierced in cases where the corporation is a mere shell, device, or puppet of the shareholder. Hassinger v. Tideland Elec. Membership Corp., 622 F. Supp. 146, 150 (D.C.N.C. 1985). When a corporation "is so operated that is is a mere instrumentality or alter ego of the sole or dominant shareholder and a shield for his activities in violation of the declared public policy or statute of the State, the corporate entity will be disregarded and the corporation and the shareholder treated as one and the same person . . ." Henderson v. Security Mortgage & Finance Co., 273 N.C. 253, 260 (1968). The test for determining whether a corporation is a "mere instrumentality" of its shareholder consists of three elements: (1) the domination

and control of the corporate entity; (2) the use of that domination and control to perpetrate a fraud or wrong; and (3) the proximate causation of the wrong complained of by the domination and control. Clark v. B.H. Holland Co., 852 F. Supp. 1268, 1276 (E.D.N.C. 194).

In the present case, the evidence clearly supports the ALJ's determination that Plaintiff controls the corporation and is the corporation's "alter ego". Plaintiff is the corporation's president, treasurer, sole shareholder, sole director, and sole attorney-employee. Since incorporating his law practice, Plaintiff has failed to consistently hold himself out as a corporation. For example, on Plaintiff's W2 forms , Plaintiff listed the employer and employee as George L. Fitzgerald (Tr. 147). Similarly, in a letter to the Administration, Plaintiff noted that he was self-employed. (Tr. 38)

The undersigned also believes there is substantial evidence in the record to support the ALJ's determination that Plaintiff has used his domination and control of the corporation to perpetrate a legal wrong. Plaintiff formed the corporation to enable himself to receive full retirement benefits. By setting his salary below the exempt amount, Plaintiff sought to obtain full benefits without reducing his hours of work. As noted by the ALJ, however, the benefits Plaintiff sought to obtain were retirement benefits, and in enacting the Social Security Act, Congress sought to provide such benefits as a partial safety for those who are forced to retire or cut back their work due to age. Congress did not intend to provide full benefits to someone in Plaintiff's position--that is, one who continues to work full-time and happens to have the means and flexibility to shelter his income in a corporate structure. Thus, the

undersigned believes there is ample support for the ALJ's determination that Plaintiff has used his control of the corporation to attempt to circumvent public policy and perpetrate an illegality. Furthermore, the undersigned finds that sufficient evidence exists to support the ALJ's conclusion that Plaintiff's control of the corporation is a proximate cause of the wrong Plaintiff sought to achieve.

Because substantial evidence supports the ALJ's decision to pierce the corporate veil, the undersigned finds the ALJ did not err in attributing the corporation's undistributed income to Plaintiff. See Rose v. Richardson, 348 F. Supp. 164 (S.D. Ohio 1972) (undistributed corporate income properly attributed to claimant where claimant incorporated business after retirement age and evidence showed corporate entity was sham behind which claimant continued to operate his sole proprietorship).

Furthermore, the undersigned finds that the ALJ's decision to deny Plaintiff retirement benefits is proper and in accordance with law.

IV **RECOMMENDATION**

WHEREFORE, on the basis of the foregoing, the undersigned Magistrate Judge respectfully recommends that Plaintiff's Motion for Summary Judgment (doc 2) be DENIED; that the Commissioner's Motion for Summary Judgment (doc. 12) be GRANTED; and that the Secretary's decision in this case be AFFIRMED.

V. **NOTICE OF APPEALS RIGHTS**

The parties are hereby advised that, pursuant to 28 U.S.C. Sec. 636 (b)(1)(C), written objections to the proposed findings of fact and conclusions of law and the recommendation contained in this Memorandum must be filed within ten (10) days after service

of same. Failure to file objections to this Memorandum with the district court constitutes a waiver of the right to de novo review by the district court, Nettles v. Wainwright, 677 F. 2d 404, 410 (5th Cir. 1982), and will preclude the parties from raising such objections of appeal. Thomas v. Arn, 474 U.S. 140 (1985); Wright v. Collins, 766 F. 2d 841, 845-46 (4th Cir. 1985); United States v. Schronce, 727 F. 2d 91 (4th Cir.), cert. Denied, 467 U.S. 1208 (1984).

This 14th day of October, 1997.

Brent H. McKnight
Brent H. McKnight
United States Magistrate Judge

SOCIAL SECURITY ADMINISTRATION

Refer to: TAHBT2 Office of Hearings and Appeals
5107 Leesburg Pike
134-16-0064 Falls Church, VA 22041-3255

ACTION OF APPEALS COUNCIL ON REQUEST FOR REVIEW
NOV 27 1996

Mr. George L. Fitzgerald
PO Box 31532
Charlotte, NC 28231

Dear Mr. Fitzgerald:

The Appeals Council has considered the request for review of the Administrative Law Judge's decision issued on December 13, 1995.

Social Security Administration regulations provide that the Appeals Council will grant a request for review where: (1) there, appears to be an abuse of discretion by the Administrative Law Judge; (2) there is an error of law; (3) the Administrative Law Judge's action, findings, or conclusions are not supported by substantial evidence; or (4) there is a broad policy or procedural issue which may effect the general public interest. (These provisions are contained in 20 CFR 404.970 for Social Security claims under Title II of the Social Security Act and in 20

CFR 416.1470 for supplemental security income claims under Title XVI of the Act.)

The Appeals Council has concluded that there is no basis under the above regulations for granting your request for review. Accordingly, your request is denied and the Administrative Law Judge's decision stands as the final decision of the Commissioner of Social Security in your case.

In reaching this conclusion, the Appeals Council considered the contentions you made in your letter dated December 18, 1995, but decided that these contentions do not provide a basis for changing the Administrative Law Judge's decision. The Council concurs with the Administrative Law Judge that deductions are imposable against your old-age insurance benefits in 1992 and 1993 based on the amount of wages that your corporation paid you plus the amount of net income that the corporation retained. Based on earnings of $79,266 for 1992, i.e., wages of $7,650 and retained earnings of $71,616, and earnings of $73,198 for 1993, i.e., wages of $10,530 and retained earnings of $62,668, no old-age insurance benefits are payable to you for those years.

If you have not already done so, you should file an annual report of your earnings for 1994 and 1995 and submit your personal and corporate tax returns for those years. The Social Security Administration will then issue an initial determination concerning the extent to which

deductions are imposable against your old-age insurance benefits in 1994 and 1995 based on the amount of your earnings for those years.

If you desire a court review of the Administrative Law Judge's decision, you may commence a civil action by filing a complaint in the United States District Court for the judicial district in which you reside within sixty (60) days from the date of receipt of this letter. It will be presumed that this letter is received within five (5) days after the date shown above unless a reasonable showing to the contrary is made. The complaint should name the Commissioner of Social Security as the defendant should include the Social Security numbers(s) shown at the top of this notice. The right to court review is provided for in section 205 (g) of the Social Security Act, as amended (42 U.S.C. 405 (g)).

If you cannot file your complaint within sixty days, you may ask the Appeals Council to extend the time in which you may begin a civil action. However, the Council will only extend the time if you provide a good reason for not meeting the deadline. Your reason(s) must be set forth clearly in your request.

If a civil action is commenced, the Commissioner must be served by sending a copy of the summons and complaint be registered or certified mail tot he General Counsel, Social Security Administration, Room 611, Altmeyer Building, 6401 Security Boulevard, Baltimore, MD

21235. (See Rules 4 (c) and (i) of the Federal Rules of Civil Procedure.) In addition, you must serve the United States Attorney for the district in which you file your complaint and the Attorney General of the United States, as provided in the Federal Rules of Civil Procedure.

Sincerely yours,

Larry K. Banks

Larry K. Banks
Administrative Appeals Judge

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Social Security Administration

Refer to: 134-16-0064 Office of Hearings and Appeals
5701 Executive Ctr. Dr., Rm400
Charlotte, NC 28212
Telephone: (704) 563-9346
Date: December 13, 1995

George L. Fitzgerald
PO Box 31532
Charlotte, NC 28231

NOTICE OF DECISION - UNFAVORABLE

I have made the enclosed decision in your case. Please read this notice and the decision carefully.

IF YOU DISAGREE WITH THE DECISION

If you do not agree with my decision, you may file an appeal with the Appeals Council.

HOW TO FILE AN APPEAL

To file an appeal you or, if you appoint one, your representative must request the Appeals Council to review the decision. You must make the request in writing. You may use our Request for Review form, HA-520, or write a letter.

You may file your request at an Social Security office or a hearing office. You may also mail your

request right to the Appeals Council, Office of Hearings and Appeals, 5107 Leesburg Pike, Fallas Church, VA 22041-3255. Please put the Social Security number shown above on any appeal you file.

TIME TO FILE AN APPEAL

To file and appeal, you must file your request for review within 60 days from the date you get this notice.

The Appeals Council assumes you got the notice 5 days after the date shown above unless you show you did not get it within the 5-day period. The Council will dismiss a late request unless you show you had a good reason for not filing on time.

TIME TO SUBMIT NEW EVIDENCE

You should submit any new evidence you wish to the Appeals Council to consider with your request for review.

HOW AN APPEAL WORKS

Our regulations state the rules the Appeals Council applies to decide whether to review a case and in reviewing a case. These rules appear in the Code of Federal Regulations, Title 20, Chapter III, Part 404, Subpart J.

If you file an appeal, the Council will consider all of my decision, even the parts with which you may agree. The Council will review your case if one of the reasons for review listed in our regulations exists. Section 404.970 of the regulations lists these reasons.

Requesting review places the entire record of your case before the Council. Review can make any part of my decision fully or partially favorable or unfavorable to you.

On review, , the Council may itself consider the issues and decide your case. The Council may also send it back to an ALJ for a new decision.

THE APPEALS COUNCIL CAN REVIEW THE DECISION ON ITS OWN MOTION

The Appeals Council can review my decision even if you do not ask it to do so. If it decides to do that, the Council will mail you a notice about its review within 60 days from the date of this notice.

IF NO APPEAL AND NO REVIEW ON THE APPEALS COUNCIL'S OWN MOTION

If you do not appeal and the Council does not review my decision on its own motion, you will not have a right to court review. My decision will be a final decision that can be changed only under special rules.

YOUR RIGHT TO REPRESENTATION IN AN APPEAL

You may have a lawyer or other person help you in any appeal you file with the Appeals Council. There are groups that can help you find a lawyer or give you free legal services if you qualify. There are also lawyers who do not charge unless you win your appeal. Your local Social Security office has a list of groups that can help you with an appeal.

If you get someone to help you with an appeal, you or that person should let the Appeals Council know. If you hire someone, we must approve the fee before he or she can collect it. And if you hire a lawyer, we will withhold up to 25 percent of any past-due benefits to pay towards the fee.

DO YOU HAVE ANY QUESTIONS

If you have any questions, you may call, write or visit any Social Security Office. If you visit an office, please bring this notice and decision with you.

Saul W. Nathanson
Administrative Law Judge

DEPARTMENT OF
HEALTH AND HUMAN SERVICES
Social Security Administration
OFFICE OF HEARINGS AND APPEALS

DECISION

IN THE CASE OF

CLAIM FOR

George L. Fitzgerald

Retirement
Insurance Benefits

claimant

135-16-0064
Social Security

Number

This case is before the Administration Law Judge on a timely request for hearing. The claimant has waived his right to an oral hearing and has requested a decision be made on the record, on the issue is a question of law. The Administrative Law Judge has carefully considered all the documents identified in the record as exhibits, the testimony at the previous hearing, and the arguments presented.

Issues

The general issues to be decided are whether the claimant has income which should be characterized as either wages or net income from self employment for purposes of the annual earnings test, and, if so, whether he has excess earnings that should be deducted from his Social Security retirement benefits.

Law And Regulations

Social security benefits are meant to replace, in part, earnings lost to an individual or a family due to retirement, disability, or death. Therefore, the amount of social security benefits which a beneficiary under age 70 may receive each year depends on whether the beneficiary is fully or partially retired. The annual earnings test is used to measure the extent of a beneficiary's retirement and thus the amount of benefits payable. For the taxable year 1992, the first $10,200.00 earned by a beneficiary age 65 or older is exempt from the test. For 1993, the exempt amount is $10,560.00,and for 1994 the exempt amount is $11,160.00. POMS RS Sec. 02501.025 Earnings beyond this threshold are referred to as excess earnings.

No matter how much a beneficiary earns in a given taxable year, no deduction on account of excess earnings will be made in the benefits payable for any month which was a "nonservice month" in the beneficiary's initial "grace year". A nonservice month is any month in which

an individual, while entitled to retirement benefits, neither works in self employment nor performs services for wages greater than the monthly exempt amount. An initial grace year is the first taxable year in which the beneficiary has a nonservice month in or after the month in which he is entitled to a retirement benefit. 20 CFR Sec. 404.435

For the purposes of the annual earnings test, "earnings" include both wages and net income from self employment. 20 CFR Sections 404.429 (a),(b). Wages are defined as all remuneration paid to an employee for employment, unless specifically excluded, irrespective of the name by which the compensation is designated or the way in which it is paid. 20 CFR Sec. 404.1041 (a), SSR 91-1c. The Social Security Act specifically regards officers of corporations as employees, even if that officer would be self-employed under common law. 20 CFR Sections 404.1006, 404.1007. Net earnings from self employment are defined as the gross income from carrying on a trade or business, as figured under the Internal Revenue Code, less the deductions attributable to that trade or business, allowed by the code. An individual works in self employment in any month in which he performs substantial services in the operation of a trade or business as an owner or a partner even though there may be no earnings or net earnings caused by the individual's services during that month.
20 CFR 404.446.

There is a statutory presumption that a claimant has rendered services for wages in excess of the exempt

amount and has engaged in self-employment until he proves otherwise to the satisfaction of the Secretary. 42 USC Sec. 403 (f)(4). Therefore, the burden of proof is on the claimant to show that money received from an employer was not for services rendered and money received from a trade or business was not in return for substantial services.

Under the Social Security Act, the Secretary has the authority to examine the substance over the form of business transactions and relationships. SSR 91-1c, incorporating Martin v. Sullivan, 894 F2d 1520 (11th Cir. 1990). In general, rental income, dividends, and interest are excluded from the definition of earnings for the annual earnings test. 20 CFR Sections 404.1082, 4004.1083. However, dividends and other types of income that are used to remunerate a corporate officer for the value of his services can be reclassified as wages. SSR 82-16.

In the Martin case, the plaintiff was the sole proprietor of an incorporated band-orchestra business. He served as president of the corporation until January 1985 when his wife became president and he contended that he had retired from the business. The court found that the plaintiff was not retired for social security purposes because he continued to manage and control the corporation after his alleged retirement and the allocation of compensation to the plaintiff and his wife was not representative of their respective services. The Eleventh Circuit expressly adopted the test used by the Sixth

Circuit in Heer v. Secretary of Health and Human Services, 670 F. 2d 653, 655 (6th Cir. 1982) (per curiam) and applied the following factors: (1) whether the claimant continues to provide substantial and valuable services to the corporation; (2) whether the family member receiving the income increases his or her deeds commensurate with the increase in salary, and (3) whether the family member's income is used to support the claimant. This case which establishes the Eleventh Circuit standards for piercing the veil of fictitious family salary arrangements for the purpose of obtaining Social Security benefits, has been adopted as Social Security Ruling 91-1c.

For a recent case, where monies received by a corporate officer from a subchapter S corporation in the form of rental income and notes receivable were reclassified as earnings, see Pointer v. Shall, 841 F. Sup. 201 (N.D. Tex. 1993). It was noted in Pointer that although 26 U.S.C. Sec. 1366 allows the character of income to pass through to the shareholders in a subchapter S corporation the pass through is for tax purposes only and not for the purpose of determining excess earnings under the Social Security Act. 26 U.S.C. Sec. 1371 (a) (1) For a recent case where dividends received by a corporate officer were reclassified as earnings, see Owens v. Sultan, 790 F. Sup. 195 (E.D. Ark. 1991).

The North Carolina Business Corporation Act governs the formation of professional corporations in North Carolina. N.C.G.S. Sec. 55 B North Carolina state law allows the corporate veil to be pierced in cases where the

corporation is a mere shell, device, or puppet of the shareholder. Hassinger v. Tideland Elec. Membership Corp., 622 F. Sup. 146, 150 (D.C.N.C. 1985) North Carolina applies the "alter ego" or "instrumentality" test. "[W]hen a corporation is so operated that it is a mere instrumentality or alter ego of the sole or dominant shareholder and a shield for his activities in violation of the declared public policy or statute of the state, the corporate entity will be disregarded and the corporation and the shareholder treated as one and the same person..." Henderson v. Security Mortgage & Finance Co., 273 N.C. 253, 260 (1968) The test for determining whether a corporation is a "mere instrumentality" under the North Carolina Law consist of three elements: (1) the domination and control of the corporate entity; 2) the use of that domination and control to perpetuate a fraud or wrong, and 3) the proximate causation of the wrong complained of by the domination and control. Clark v. B. H. Holland Co., Inc., 852 F. Supp. 1268, 1276 (E.D.N.C. 1994), citing Atlantic Tobacco Co., v. Honeycutt, 101 N.C. App. 160, 164 (1990)

The claimant, Mr. George Fitzgerald, is an attorney whose practice consists mainly of social security appeals. He filed an application for Social Security retirement insurance benefits on May 22, 1991, shortly before he attained age 65. (Exhibit 1) On May 28, 1991, the claimant was notified that no benefits were payable based on his estimate of earnings for 1991. (Exhibit 2)

On July 31, 1991, Mr. Fitzgerald incorporated his business as a professional corporation organized to

practice law at North Carolina. The Articles of Incorporation were filled with the office of the Secretary of State on September 10, 1991. On November 5, 1991, Mr. Fitzgerald wrote in a letter addressed to a social security representative, "I would like my retirement checks to start in January 1992. My income from self-employment will be less than the $8,840 limit." (Exhibit 3) On February 6, 1992, the claimant signed a statement to the effect that he wished to receive social security benefits effective with January 1992, that he had incorporated his business as George Fitzgerald, P.C., that 99% of his business involved representing social security claimants, that no other attorneys were employed by the corporation so that he would continue doing all the work that needed to be done, that he did not plan to reduce his services or the time that he spent working, and that the corporation would pay him $850.00 per month for the work that he did. (Exhibit 4)

On March 19, 1992, Mr. Fitzgerald was notified that his social security retirement payments were suspended on the basis that, for retirement purposes, he could be charged with his salary plus the ordinary income of the corporation . (Exhibit 5) On June 2, 1992, after he had requested reconsideration, Mr. Fitzgerald was notified that he had not satisfactorily established retirement to an extent that would permit benefits for 1992. This reconsideration determination also advised him to file an annual report of earnings, along with a copy of his personal and corporate tax returns, after the close of the year. (Exhibit 7) The claimant subsequently requested a hearing. His appeal was denied by an Administrative Law

Judge on November 23, 1992, and he filed a request for review of the hearing decision. (Exhibits B-1, B-2)

On February 7, 1994, the Appeals Council dismissed the request for hearing on the basis that the suspension of benefits pending an investigation was not an initial determination subject to the administrative review process. The case was referred to the administrative review process. The case was referred to the Northeastern Program Service Center for an initial determination regarding the actual amount of earnings for 1992. (Exhibit B-3) On October 31, 1994, Mr. Fitzgerald was notified that his earnings for 1992 and 1993 were too high to permit payment. On February 28, 1995, after he had requested reconsideration, Mr. Fitzgerald was notified that no benefits were payable because he had not met the requirements for retirement. (Exhibit B-8) The claimant filed a timely request for hearing.

Since the claimant waived his right to an oral hearing on the basis that he and his bookkeeper had testified previously, I am using the testimony given at the prior hearing as evidence. I am not using the findings or conclusions of the decision dated November 23, 1992, by another Administrative Law Judge, which was vacated by the Appeals Council's decision.

At the hearing held on September 25, 1992, Mr. Fitzgerald testified that he incorporated as a professional corporation in September 1991 and that the corporation began doing business in January 1992, that he takes a gross salary of $850.00 per month that he has passive

income from savings, investments, and rental property, that all of the income from his law practice is paid into a separate bank account for the corporation, that the corporation pays all of the expenses connected with the law practice and that the corporation pays taxes as a C corporation and he is subject to double taxation. Mr. Fitzgerald also state that he owns the building which has 2 condominium units, one of which is rented to the corporation for his law practice, that he has operated in this unit since 1982, that the corporation pays him $750 per month in rent, and than when he was the sole proprietor of the law firm he did not deduct any rental income from his net self employment income although he did deduct property depreciation as a business expense. Mr. Fitzgerald further testified that he is the president and only director of the corporation, that he is the only shareholder, and that the corporation employs his secretary and also a cleaning woman.

Mr. Fitzgerald further testified that he has not reduced his activities or hours of work since incorporating, that he sets his own salary, that he is able to declare dividends but the corporation has not paid any dividends, that all of the profits are retained in the corporation bank account, that he intends to retain all profits and not to pay dividends, and that he would be able to distribute all of the retained profits as a dividend to himself at age 71. The claimant stated that he had practiced law for 40 years. When asked what the motivating factor was for incorporation after being in business for many years, Mr. Fitzgerald replied that "it was my intention that by incorporating that I would be able to, within the law, be

able to draw my social security benefits." He added that his review of the case law indicated that the courts would not "pierce the corporate veil" as long as an individual was honest about his activities and did not resort to fraud or subterfuge. Mr. Fitzgerald stated that, although he has the legal authority to gain access to all of the corporation's income by declaring dividends, he has not done so, and therefore this income could not be characterized as available to him. He stated that individuals are allowed by law to minimize their tax liability and to form corporations for the benefit of the incorporator. He also said that he had paid social security taxes for many years and was entitled to benefits, and that he was pursuing this as a matter of principle.

The claimant's secretary, Linda Outen, testified that she has been employed by Mr. Fitzgerald continuously since 1976, that she keeps the checkbooks and writes all checks, that no checks have been written to Mr Fitzgerald by the corporation other than his salary checks and the rental checks, and that money was transferred from his personal account to the corporate account when the corporation was set up to cover initial expenses but no money has been transferred from the corporation to Mr. Fitzgerald. Ms. Outen further testified that prior to incorporation the claimant had a separate checking account for his business expenses and that this account was closed in 1990 before the corporation account was opened. She stated that, prior to incorporation, Mr. Fitzgerald did not draw a set salary for himself but took money out of his business account as needed by telling her to write him a check. She also stated that, although

she fills out and posts the checks, Mr. Fitzgerald is the only person who is authorized to sign checks from the corporate account.

The claimant's testimony, and the testimony of his secretary, was credible to establish that there has been no change in the operation of his business since his incorporation.

The tax returns submitted by the claimant show the following amounts

YEAR	CORP GROSS	CORP TAXABLE	SALARY
1992	$202,507	$108,509	$7,650
1993	213,264	96,413	10,530
1994	-------	-------	11, 160

The tax returns also show that on August 1, 1993, the corporation bought property from Mr. Fitzgerald for $38,078.00. (Exhibit B-13) In comparison, Mr. Fitzgerald's net income from self-employment in 1990 was $122,577.00. (Exhibit 9)

Mr. Fitzgerald submitted a Memorandum of Law arguing that he is entitled to monthly benefits because his only countable income is the salary he receives from the Corporation, that there is nothing wrong with his having arranged his affairs to maximize his social security benefits, that all of the social security cases in which the corporate veil has been pierced involve shifting income to family members and that the corporate structure is

disregarded only where there are abuses, that by incorporating he is subject to double taxation, and that George Fitzgerald, P.C. is a corporation which has an identity that is legally separate and distinct from the claimant. (Exhibit 17).

In is Memorandum of Law, the claimant cited the case of Taubenfeld v. Bowen, 685 F. Supp. 237 (S.D. Fla. 1988) as support for his assertion, that the Corporate veil cannot be pierced because the Corporation's retained earnings are not available to him and cannot be counted as income. (Exhibit 17) However, the facts in Taubenfeld are quite different from the facts in the present case. Mr. Taubenfeld was the president and operator of a small, family owned closed corporation which operated a retain men's clothing store. When he retired, he resigned as president and operator of the business and reduced his working hours from 200 hours per month to 72 hours per month, with a commensurate reduction in salary compensation, and he claimed that his wife and sons had taken over the bulk of the business duties. Mr. Taubenfeld presented evidence that he had substantially curtailed his work activity. The Social Security Administration found that Mr. Taubenfeld had not "retired" because he was still in a position to control all of the business activities of the corporation, including his own earnings. The court found that the Secretary's determination that Mr. Taubenfeld had not retired was incorrect as a matter of law and remanded the case because there was no finding that Mr. Taubenfeld's wife and son received wages which were not commensurate with their allegedly increased duties. The courts added

that, should the Secretary make such a finding, the monies allocated by the Secretary to Taubenfeld would necessarily have to consist of the sham payments to family members, not undistributed corporate earnings. The court found that there was no evidence that the corporate form of the business was a sham or other than bona fide. "For example, there is no evidence that Mr. Taubenfeld...runs the business as a sole proprietorship." 685 F. Supp. 237.

Taubenfeld differs from the present case in several ways: the corporation was in existence prior to Mr. Taubenfeld's retirement; the corporation had a bona fide purpose, to operate a store; the corporation was not a sole proprietorship; Mr. Taubenfeld reduced his hours of work and his duties when he retired; and other family members assumed the duties that Mr. Taubenfeld relinquished. In the present case, the claimant operated his business as a self employed sole proprietor for many years and incorporated only at age 65; the claimant admitted that the purpose of incorporation was to permit him to draw social security benefits; the claimant was the sole officer and shareholder of the corporation; the claimant performed all of the duties required by the business; the claimant did not change his hours or work or his duties; and no one else took over any of his duties or responsibilities.

Although the claimant argues that the corporation has a separate and distinct identity, he has not consistently held himself out as a corporation. For example, although the claimant's letterhead now shows "P.C.", his W-2 forms

show both the employer and employee as George L. Fitzgerald, with the same address for both.

Mr. Fitzgerald continued to regard himself as self employed, even after his incorporation. (Exhibit 3) By his own admission, the amount of his salary is tied to the social security exempt amount and bears no relation to the value of his services. The claimant testified that he has no access to the corporate income and that he does not intend to pay any dividends. However, he conceded that he has the legal authority to pay himself dividends or to simply write a check to himself from the corporate account at any time. In effect, the claimant is treating his retained earnings as an Individual retirement account or a savings account to which his earnings are directly deposited. If he needs income prior to age 70, he can pay himself dividends or buy some property from himself, as he did in 1993.

The claimant also argues that his rental income and dividends are excluded as income under 42 U.S.C. Sec. 411. However, as shown in the cases cited above, when a corporate officer's salary does not reflect the extent of his services to the corporation, both rental income and dividends can be reclassified as earnings.

Mr. Fitzgerald argued that he is subject to double taxation because he pays both corporate tax and individual tax on his earnings. However, he had the option of avoiding this double taxation by electing to form an S corporation instead of a C corporation. If he had elected an S corporation, he would not be subject to double taxation

because the income would pass through to him each year. However, the election of an S corporation would not have allowed the corporation to retain any of its earnings. A person may properly arrange his business, personal and professional affairs as to maximize his income. This is settled law.

It appears after reviewing all the facts in this case it is manifest that Mr. Fitzgerald established this legal fiction with the primary, if not exclusive purpose of evading the "excess earnings" benefit offset. Consideration is given to the fact that this personal corporation was established at or around the time of his becoming 65 years old, his subsequent "retirement", his being the sole stockholder, his payment of a salary commensurate with the maximum amount allowed without benefit offset, and his continued performance of services at the same level as prior to his "retirement".

However, it must also be remembered that the benefits in question are retirement benefits, and it is the intent of the Act that the beneficiary be retired within the meaning of the Law to be eligible for full monthly benefits. The intent of the Act cannot be circumvented, however, by arrangements whereby reported earnings are substantially less than the value of the services performed and the real value of the services performed are received as remuneration in a different manner. SSR 82-16.

In other cases, cited herein, some of the claimants received remuneration in other forms in an attempt to evade the characterization of wages as to subject that

money to the excess earnings benefit offset. Some took the "wages" as dividends, or as rent, or shifted the salary to family members. In this case it is unknown at the present what form the excess earnings may take in the future but it at the very least has resulted in an increase in the value of stock. 100% of which is retained by Mr. Fitzgerald. He may use such stock as collateral or decide at any time to declare a dividend, etc...

The Commissioner of Social Security is authorized to examine the substance of business transactions and relationships in order to determine if a retired individual actually rendered substantial
services while supposedly retired. 42 U.S.C. 403 (f)(4)(A),(B); accord Heer v. Secretary, 670 F. 2d 653, 655 (6th Cir. 1982); Holden v. Secretary, 641 F. 2d at 409; Skalet v. Finch, 431 F. 2d 452 (6th Cir. 1970). "The Secretary has, without question, the authority and the duty to pierce any fictitious arrangement...to shift salary payments." Gardner v. Hall, 366 F. 2d 132 (10th Cir. 1969).
In Gordon v. Finch, 437 F. 2d 253 (1971) the Eighth Circuit stated that
Skalet v. Finch, 431 F. 2d 452 determined that "the Secretary has the authority to consider the substance of any transaction over its form, citing Ludeking v. Finch, 421 F. 2d 499 (8th Cir. 1970). Prof. Peter W. Martin, Cornell University, in his seminal treatise has stated, in determining the beneficiary's earnings the Agency does not always accept the individuals own characterization or

formal legal structures or income tax treatment of the situation. When it appears that a business has been restructured to convert income that would otherwise be earnings for a beneficiary into some other format the Agency has the right to apply that against the excess earnings test. Martin on Social Security. Clark Boardman Callaghan. Deerfield, IL.

What may be valid and legal arrangement for one purpose, may be for other purposes, not have met the necessary requirements to be afforded recognition. Commissioner v. Culbertson, 337 U.S. 733 (1949). Even though the transaction might entitle the person to exercise certain rights under state law, the Secretary and the Courts may so recognize the true situation for Social Security purposes. The Social Security Administration may look into the bona fides of the transaction, and if the evidence warrants, declare the invalidity of the transfer regardless of the position of the legal title. Hellberg v. Celebrezze, 245 F. Supp 390 (W.D.Mo. 1965).

In his Memorandum of Law Mr. Fitzgerald states, "Claimant does not deny he structured his affairs to receive SS benefits." Further he avers that this entity has resulted in the loss of his SEP deduction evidencing how calculating and mercenary is this restructuring.

The cases cited by Mr. Fitzgerald are not on point since a careful and objective analysis indicates that these instances refer to those situations where the income of the wage earner were shifted to another family member. Merely reclassifying "wages" as "retained earnings" does not alter the fact that Mr. Fitzgerald received these monies for services rendered and not as amorphous corporate income

Mr. Fitzgerald further seeks to legitimize his actions by stating "If money is paid to the claimant after he reaches age 70 by the P.C. then it will be taxed a second time by the State and U.S. Government." However this ignores the fact that once Mr. Fitzgerald becomes age 70 he will be permitted to earn any amount without a corresponding offset of benefits. There is no question but at that time Mr. Fitzgerald will dissolve the P.C. and return to his prior status and report his true income.

He states, "he should not be penalized because he has greater flexibility than the average wage earner." This is the clearest revelation of his attempt to flout the unambiguous intent of the Act and public policy set forth by Congress to establish Social Security retirement benefits to act as a partial safety net for those who retire due to age and not a blank canvas for cunning manipulators of the language and arcane maze of the law to unfairly take advantage of semantics. (Exhibit 17)

There is a presumption that a beneficiary has engaged in self-employment or rendered services for wages with countable income in excess of the exempt amount until it is shown not to be the case to the satisfaction of the Commissioner . SSA. 42 U.S.C. 403 (f)(4).

Therefore, the facts and law in this case ineluctably lead to the conclusion that the personal corporation established by Mr. Fitzgerald was a blatant attempt to evade the limitations established by Congress by setting up a sham legal structure while continuing to work full-time and collect full retirement benefits.

Although the claimant was honest and open about his activities, it is clear that his motive was to circumvent public policy. I find that George L. Fitzgerald, P.C., is the "alter ego" of George Fitzgerald, the individual. Therefore, the corporate veil must be pierced and the net income of the corporation must be characterized as his income for retirement test purposes. For retirement test purposes, his earnings consist of his salary plus the net income of his corporation. His earnings are too high to allow payment of monthly social security benefits in the years 1992 through 1994 and it is estimated that his earnings will be too high to allow payment in 1995.

The claimant has failed to establish a "non-service month" or a "grace year" within the meaning of the Regulations. Based on the evidence discussed above, I find that the claimant was not "retired" for social security purposes in the years 1992 through 1994. He is not entitled to retirement insurance benefits.

FINDINGS

After careful consideration of the entire record, the Administrative Law Judge makes the following findings.

1. The claimant filed an application for retirement insurance benefits on Maay 22, 1991.

2. The claimant attained age 62 on July 8, 1986.

3. The claimant was eligible for retirement insurance benefits.

4. The claimant incorporated his business in September 1991 and began doing business as a corporation in January 1992.

5. The claimant is the sole director and shareholder of George Fitzgerald, P.C.

6. The claimant's testimony was credible to establish that here has been no change in his business activities or in his hours worked since his incorporation.

7. George Fitzgerald, P.C. is an "alter ego" of George Fitzgerald, the individual.

8. For retirement test purposes, the claimant's earnings consist of both his salary and the net income of the corporation.

9 Since the claimant's monthly wages since 1991 have exceeded the monthly exempt amount set in the Regulations, he has failed to establish a "nonservice month" and, therefore, a "grace year", as defined by the Regulations.

10. Based on the amount of his earnings, the claimant is not entitled to retirement insurance benefits.

DECISION

It is the decision of the Administrative Law Judge that, based on the application filed May 22, 1991, the claiamant is not entitled to retirement insurance benefits.

Saul W. Nathanson

_____

Saul W. Nathanson
Administrative Law Judge

December 13, 1995

_____

Date

LIST OF EXHIBITS

George L. Fitzgerald (Claimant) 134-16-0064 (Social Security Number)

EXHIBIT NO.	DESCRIPTION	NO. OF PAGES
1	Application for Retirement insurance benefits filed 5/22/91	3
2	Notice of Award, dated 5/28/91	3
3	Letter from claimant, 11/5/91	1
4	Statement of claimant, 2/6/92	2
5	Notice of Determination, and Special Reconsideration Determination, 3/19/92	4
6	Request for Reconsideration filed 4/2/92	3
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8	Request for Hearing filed 6/11/92	3
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11.	Certificate of incorporators and application for certificate of registration	3
12.	Certificate of Registration with NC State Bar	1
13.	Certified copy of Corporate Resolutions-Opening and Maintaining Accts.	2
14.	Articles of incorporation	6
15.	Minutes of first meeting of Board of Directors, November 7, 1991	
16	Earnings Record, September 22, 1992	6

EXHIBITS SUBMITTED AT ORAL HEARING BY CLAIMANT/REP

17	Memorandum of Law	7

LIST OF EXHIBITS

George L. Fitzgerald (claimant) — 134-16-0064 Social Security Number

EXHIBIT NO.	DESCRIPTION	NO. OF PAGES
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B-2	Request for Review of Hearing Decision, 12/7/92	3
B-3	Notice from Appeals Council, 10/19/93	2
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DEPARTMENT OF
HEALTH AND HUMAN SERVICES
Social Security Administration
OFFICE OF HEARINGS AND APPEALS

ORDER OF APPEALS COUNCIL

In the case of

George L. Fitzgerald

Claim for

Old-Age Insurance Benefits

134-16-0064

On October 19, 1993, the Appeals Council granted the claimant's request for review of the Administrative Law Judges decision issued on November 23, 1992. The Appeals Council may review an Administrative Law Judge's decison to dismiss the request for hearing for any reason for which it could have been dismissed by the Adminstrative Law Judge.

In connection with the the request for review, the claimant requested a duplicate cassette of the hearing held on September 25, 1992. The Appeals Council sent a duplicate cassette to the claimant on January 12, 1993 and granted him time to submit additional evidence and/or argument. Nothing further from the claimant has been received.

In his decision, the Administrative Law Judge found that the net earnings of the claimant's professional corporation and the value of his services to the corporation could reasonably be expected to exceed the amount allowable

under the earnings test for 1992. He concluded that the claimant was not entitled to retirement benefits.

The suspension of old-age insurance benefits by the Social Security Administration on the basis that it could reasonably be expected that such benefits would be subject to deductions for all or part of 1992 is an action permitted by section 203(h)(3) of the Social Security Act. However, according to 20 CFR 404.903(a), suspension of benefits pending an investigation and determination of any factual issue relating to deductions on account of work is not an initial determination subject to administrative or judicial review. Therefore, the Appeals Council has concluded that the suspension of the claimant's benefits was not an initial determination subject to the administrative review process and that the claimant had no right to a hearing before an Administrative Law Judge

In view of the above, the claimant's request for hearing filed on June 11, 1992, should had been dismissed by the Administrative Law Judge as provided by 20 CFR 404.957(c)(2) because the claimant had no right to a hearing (20 CFR 404.930).

Accordingly, the Appeals Council hereby dismisses the request for hearing filed on June 11, 1992. The claimant's file will be referred to the Northeastern Program Service Center for an initial determination regarding the amount of his 1992 earnings and applicable work deductions, if any. The claimant will have full appeal rights from any determination issued.

Accordingly, the Appeals Council hereby dismisses the request for hearing filed on June 11, 1992. The claimant's file will be referred to the Northeastern Program Service Center for an initial determination regarding the amount of his 1992 earnings and applicable work deductions, if any. The claimant will have full appeal rights from any determination issued.

Notice of this action is hereby given by mailing a copy to the claimant.

APPEALS COUNCIL

_____

David G. Hatfield
Administrative Appeals Judge

_____

Larry K. Banks
Administrative Appeals Judge

Date: Feb-7 1994

Claimant's Name and Address
George L. Fitzgerald
PO Box 31532
Charlotte, NC 28231

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Social Security Administration

Refer to: 134-16-0064

Office of Hearings and Appeals
5701 Executive Ctr. Dr., Rm400
Charlotte, NC 28212
Telephone: (704) 563-9346
Date: November 17, 1992

George L. Fitzgerald
PO Box 31532
Charlotte, NC 28231

NOTICE OF DECISION - DENIAL
PLEASE READ CAREFULLY

If You Think the Decision is Wrong

* You have the right to appeal. You must file your appeal within 60 days from the date you receive this notice. The "Date you receive notice" means 5 days after the date shown below, unless you show us that you did not receive it within the 5-day period.)

* When you appeal, you request that the Appeals Council review the decision. If the Appeals Council grants your request, it will review the entire record in your case. It will review those parts of the decision which you think

are wrong. It will also review those parts which you think are correct and may make them unfavorable or less favorable to you. You will receive a new decision.

* You (or your representative) have to ask for the appeal in writing. You may sign a form HA-520, called "Request for Review by the Appeals Council," or write a letter.

* You may submit your appeal to your local Social Security Office, or a hearing office, or mail it directly to the Appeals Council, Office of Hearings and Appeals, PO Box 3200, Arlington, VA 22203.

The Appeals Council May Review the Decision Even If You Do Not File an Appeal

* Within 60 days from the date shown below, the Appeals Council may review the decision on its own motion. This could change the decision.

* After the 60-day period, the Appeals Council may reopen and revise the decision in certain situtations.

* The Appeals Council will notify you if it decides to review the decision on its own motion or to reopen and revise the decision.

Unless you request review within the 60 day period or the Appeals Council reviews the decision on its own motion,

you may not obtain a court review of your case (sections 205(g), 1631 (c)(3) or 1869 (b) of the Social Security Act).

Your Right To Representation

* You may appoint an attorney or other qualified person to represent you in in appeal you may file with the Appeals Council. Your local Social Security office has a list of groups that can help you find an attorney.

* Some private attorneys do not charge a fee unless you receive benefits. Some legal services organizations can provide legal services free of charge if you meet the organization's qualifying requirements. A representative may not collect a fee for services performed in representing you in dealing with un unless we have approved the fee.

This notice and the enclosed copy of
decison mailed
NOV 23 1992

Replaces Form HA-L5023-U7

DEPARTMENT OF
HEALTH AND HUMAN SERVICES
Social Security Administration
OFFICE OF HEARINGS AND APPEALS

DECISION

IN THE CASE OF

George L. Fitzgerald

(Claimant)

Wage Earner

CLAIM FOR

Retirement Security Income

134-16-0064 (Social Security Number)

ISSUES

The general issue to determine is whether the claimant is entitled to retirement security income under Section 202 (1) of the Social Security Act. The specific issues are whether he is engaged in self-employment or rendering services for wages, and whether his "earned income" is in excess of the amount allowed under the "earnings test" of the Act.

EVALUATION OF EVIDENCE

The claimant is an attorney licensed to practice law in North Carolina. He was born on July 8, 1926, and attained age 65 in 1991. On May 22, 1991, the claimant

filed an application for retirement insurance benefits (Exhibit 1).

It is important to note the clear distinction between "eligibility" to retirements benefits under the Social Security Act and "entitlement" to benefits. In order to be eligible for benefits, an individual must file an application and meet age and insured "quarters of coverage" requirements. To become "entitled" to benefits an individual between the ages of 62 and 70 years must both be eligible for benefits and comply with an "earnings test" to actually receive retirement benefits. As a result of his application the claimant was found to be "eligible" for benefits. However, because he continued to work in 1991, no benefits were payable to the claimant due to his excess earnings. Pursuant to Section 203 (b) of the Social Security Act, deductions are made from benefit payments for excess earnings. In calendar year 1991, a retirement insurance beneficiary attaining age 62 and below age 70 could earn $810 per month or $9,720 in a calendar year and receive all benefits due them. For earnings over that amount, the claimant is charged with $1.00 for every $3.00 earned (i.e. excess earnings for calendar years 1991 and 1992 are 33 1/3 of the earnings above the exempt amount). Since this claimant earned $53,400 in calendar year 1991 (Exhibit 16), he reeived no retirement benefits from Social Security. It is noted that in calendar year 1992, the earnings limit increased to $850.00 per month or $10,200 per year.

To avoid the ambiguity which sometimes surrounds "retirement cases" it is important to distinguish between the "retirement" aspects of the Act and its "earnings test". In the legislative history of the Act, one can find the clear intent of its framers. The Act was initially designed to "partially" replace income lost due to retirement. It was

contemplated that other types of retirement and investment income would supplement the Social Security benefits upon the worker's retirement. For that reason the Act contains an "earnings test". The provisions of that test are found in Section 203 (b) of the Act and have been discussed in the preceding paragraph. It should also be noted that in keeping with the legislative intent of the Act, certain types of income were exempt from the earnings test. The so called "non-earned" incomes include, but are not limited to, rental income, dividends and other income not "earned" as wages or self-employment income. The clearest indication that entitlement is based on earnings rather than "retirement" is found in the fact that a potential beneficiary could have worked full time in 1991 at the minimum wage and still receive all benefits due them. Therefore, properly framed, the sole issue in this case is not whether the claimant is "retired" but rather whether he has reduced his earned income below the level required to receive all or part of his Social Security retirement benefits beginning with the month of January 1992 through the month prior to the month he attains age 70.

The claimant is this case had indicated that, beginning in January 1992, his yearly earned income would be less than the $10,200 limit and requested benefits to begin on that date (Exhibit 3). The claimant stated that, effective Sepember 1991, he had incorporated his law practice and that beginning in January 1992, the corporation would pay him a salary of $850.00 per month (or $10,200 per year) for the work that he will perform. The claimant stated that he did not plan to reduce his services or the amount of time he spent working. He stated that approximately 99% of his business involved representing Social Security claimants and that no other attorneys were

employed by the corporation. He stated that he would continue to do "all the work that needed to be done" (Exhibit 4).

The claimant was informed by the payment processing center that he still could not begin receiving benefits because, for purposes of determining earnings, he would be charged with his "salary" plus the ordinary income of his corporation. (Exhibit 5).

The claimant filed a timely request for a hearing. A hearing was held on September 25, 1992, in Charlotte, North Carolina. The claimant was present and testified. Also testifying was the claimant's secretary Ms. Linda Outen. The claimant was asked to submit a brief outlining his legal position. At the hearing, the claimant submitted a document entitled "Memorandum of Law" (Exhibit 17).

The facts in this case are undisputed. Prior to September, 1991, the claimant had operated his law office as a self-employed sole practitioner for many years. As indicated earlier, the claimant filed an application for retirement insurance benefits on May 22, 1991, electing benefits effective July 1991 when he attained age 65. No benefits were paid to the claimant in 1991 because he earned $53,400.00 net earnings from self-employment as an attorney for that calendar year and continued to work full-time.

In September 1991, the claimant incorporated his law practice. Beginning January 1992 the corporation began paying him a salary of $850.00 per month. His work activity remained the same. He then requested that monthly benefits be paid to him beginning January 1992.

His request was denied initially and upon reconsideration his denial of benefits was upheld. He timely perfected his request for hearing. The only issue is whether the claimant is entitled to receive Social Security retirement benefits beginning January 1992.

The Courts have held that the Social Security Administration may inquire into the business affairs of a claimant's corporation to determine whether the corporation has been established solely for the purpose of receiving retirement benefits that would not have ordinarily been payable. There does not necessarily need to be fraud involved for this examination to take place. Martin v. Sullivan, 894 F. 2d 1520 (11th Cir. 1990). In the instant case the claimant has clearly done nothing different relative to his business except change from a self-employed practitioner to a corporate director. His business activities are the same and the nature of the business has not changed. He has simply elected to pay himself a "salary" of $850.00 per month in order to be entitled to monthly retirement benefits.

While the claimant may do whatever he chooses for tax purposes, if his action are legal, it is clear that his action violate the spirit of the Act for the purposes of allowing him to become entitled to retirement benefits. The claimant is the only stockholder and is the director. He has full control of the expenditures and salaries paid including that to himself and to his secretary. It is clear that he has the power to pay to himself at any time some or all of the profits of the corporation and designate them "dividends" or "rents" of any other "nonearned" income category that he chooses. In the alternative, he may allow the profits to accumulate until he is age 70 and pay

himself deferred compensation at that time.

Another approach to this situation is to look at the claimant's net self-employment income prior to 1991. In 1990 he had gross earnings of $122,577. In 1992 he proposes to pay himself a salary of $850. per month as an employee of his solely owned corporation. One has to question why services worth $122,000.00 in 1990 are suddenly worth only $10,200.00 in 1992. The facts of the case clearly lead one to conclude that incorporation by the claimant was done solely to receive benefits that he would not have been entitled to had he continued as a self-employed individual.

To allow the claimant to do so would be unfair to the millions of wage earners who do not have this option available to them. It is a clear violation of the spirit of the Act. Therefore, it must be determined that based on all the evidence of record, the claimant's earned income subject to the earnings test for 1992 will be such that the claimant is not entitled to benefits.

FINDINGS

After careful consideration of all of the evidence in this case, the Administrative Law Judge makes the following findings.

1. The claimant is an attorney licensed to practice law in North Carolina. Prior to September 1991, he operated his law office as a self-employed sole practitioner.
2. The claimant attained age 65 in 1991. On May 22, 1991, he filed an application for retirement insurance benefits.

3. Since the claimant earned $53,400 in calendar year 1991 and continued to work full time, he has received no retirement benefits from Social Security.

4. Effective September 1991, the claimant incorporated his law practice, and beginning in January 1992, the corporation began paying him a salary of $850.00 per month for the work he performed. The claimant is the only stockholder and is the director of the corporation.

5. The claimant has not reduced his services or the amount of time he devotes to his law practice.

6. The only change in the claimant's law practice is his change from self-employed practitioner to corporate entity. The claimant has full control of the expenditures and distributions. As such, the corporation is in fact his "alter ego."

7. Arranging his business affairs in the manner accomplished by the claimant for the sole purpose of avoiding the earnings test in order to receive retirement benefits violates the spirit of the Social Security Act.

8. Both the net earnings of the corporation and value of the services to be rendered by the claimant can reasonably be expected to exceed the amount allowable under the earnings test for calendar year 1992 and for years prior to age 70.

9. The claimant is not entitled to retirement security income.

DECISION

The claimant has not met the requirements necessary under the "earnings test" within the meaning of the Social Security Act and, therefore, is not entitled to retirement security income.

Theodore Haynes

Theodore Haynes
Administrative Law Judge

Nov 23, 1992

Date

LIST OF EXHIBITS

George L. Fitzgerald (Claimant) — 134-16-0064 (Social Security Number)

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Supreme Court, U.S.
FILED
MAY 26 1999

(3)

No. 98-1595

In the Supreme Court of the United States

GEORGE LAWRENCE FITZGERALD, PETITIONER

v.

KENNETH S. APFEL, COMMISSIONER OF SOCIAL SECURITY

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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9pp

QUESTION PRESENTED

Whether substantial evidence supports the decision of the Commissioner of Social Security to pierce the veil of petitioner's corporation and allocate undistributed corporate profits to petitioner as wages for purposes of determining whether petitioner received excess earnings that reduced the amount of his Social Security retirement benefits.

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In the Supreme Court of the United States

No. 98-1595

GEORGE LAWRENCE FITZGERALD, PETITIONER

v.

KENNETH S. APFEL, COMMISSIONER
OF SOCIAL SECURITY

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 12-16) is unpublished, but the decision is noted at 165 F.3d 910 (Table). The judgment and order of the district court (Pet. App. 17-19) affirming the memorandum and recommendation of the magistrate (Pet. App. 20-36) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on November 13, 1998. The petition for a writ of certiorari was filed on January 22, 1999. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

The Social Security Act, 42 U.S.C. 301 *et seq.*, limits the amount of income qualified applicants seeking retirement benefits may earn yearly, either through work for others or self-employment. 42 U.S.C. 403(b). Income in excess of the statutory limit is considered excess earnings and is deducted from the applicant's retirement benefit. 42 U.S.C. 403(f).

Petitioner, George L. Fitzgerald, is a licensed North Carolina attorney practicing as a solo practitioner. In May 1991, at age 65, he applied for retirement insurance benefits with the Social Security Administration (SSA). SSA found petitioner eligible for retirement benefits, but determined that excess earnings from his continued work offset the benefits due. In September 1991, petitioner incorporated his law practice, designating himself as president and treasurer and his legal assistant as secretary. In November 1991, petitioner notified SSA that his income from self-employment would be less than the $8840 limit, and he requested retirement benefits beginning in January 1992. In February 1992, petitioner informed SSA that the corporation had been in operation since January 1992, that he was the only attorney employed by the corporation, and that he drew a salary of $850 per month. Corporate tax returns indicated that the corporation grossed $202,507 in 1992 and $213,264 in 1993. Pet. App. 13.

In March 1992, SSA notified petitioner that he would not be paid Social Security retirement benefits because, for earnings-test purposes, he would be charged with his salary plus the ordinary income from his corporation. Pet. App. 51. In November 1992, after a hearing, an administrative law judge (ALJ) affirmed that deter-

mination, concluding that the corporation was the "alter ego" of petitioner and was established "for the sole purpose of avoiding the earnings test." *Id.* at 80. The ALJ, noting that petitioner's legal duties continued as before incorporation, ruled that petitioner's true annual income equaled his salary plus the value of his services to the corporation—*i.e.*, the corporation's net earnings. *Ibid.* SSA subsequently informed petitioner that excess earnings for 1992, 1993, and 1994 would prevent him from receiving retirement benefits for those years as well. *Id.* at 63. Petitioner also challenged those determinations. On December 13, 1995, the ALJ again denied petitioner's claim for retirement benefits, citing petitioner's excess earnings based on his salary and the corporation's net income. *Id.* at 41-65. The Appeals Council denied review, and the ALJ's decision became the final decision of the Commissioner of Social Security (Commissioner). *Id.* at 37-40.

Petitioner sought judicial review in federal district court, and both parties moved for summary judgment. Following the recommendation of the magistrate, the district court granted summary judgment in favor of the Commissioner. Pet. App. 18-19. Petitioner appealed, and the court of appeals affirmed in an unpublished, per curiam decision. *Id.* at 12-16. The court of appeals concluded that there was substantial evidence to support the Commissioner's determination that petitioner was not entitled to retirement benefits. *Ibid.* The court of appeals reasoned that petitioner "had not retired from the practice of law nor had he relinquished any of the major managerial responsibilities of the corporation. * * * He worked the same number of hours, earning the same rate of income for himself and the corporation while drawing a disproportionately small salary that bore no relation to his

connection with the labor market. * * * He retained complete decision-making authority of the corporation as its president, treasurer, and sole shareholder." *Id.* at 15-16. Accordingly the court concluded that because petitioner "continued to contribute substantial services to the corporation and ran the business as if it were a sole proprietorship," the corporation "was not bona fide," and the Commissioner's decision "to pierce [the] fictitious salary arrangement and allocate the corporate earnings to [petitioner] personally was also supported by substantial evidence." *Id.* at 16.

ARGUMENT

Contrary to petitioner's contentions (Pet. 8-11), the court of appeals' judgment upholding the Commissioner's decision to pierce the corporate veil and to allocate undistributed corporate profits as personal earnings of petitioner is correct and does not conflict with any decision of another court of appeals. Accordingly, review by this Court is unwarranted.

1. The court of appeals correctly affirmed the Commissioner's decision to pierce the veil of petitioner's corporation. In applying the excess-earnings test, it is the responsibility of the Commissioner to determine whether an applicant's earnings are "related to the reality of his connection with the labor market." Pet. App. 15 (quoting *Martin* v. *Sullivan*, 894 F.2d 1520, 1524 (11th Cir. 1990)). The Commissioner also "has the authority to examine the substance of business transactions rather than [their] form and has the duty to pierce any fictitious arrangements designed to shift salary payments." Pet. App. 15. See also *Heer* v. *HHS*, 670 F.2d 653, 655 (6th Cir. 1982).

As the court of appeals observed, petitioner "had not [really] retired from the practice of law nor had he

relinquished any of the major managerial responsibilities of the corporation." Pet. App. 15. Petitioner worked the same number of hours and earned the "same rate of income for himself and the corporation while drawing a disproportionately small salary that bore no relation to his connection with the labor market." *Ibid.* Indeed, petitioner admitted that he incorporated his law practice and set his salary at $850 per month for the sole purpose of meeting the earnings test for receiving Social Security retirement benefits. *Id.* at 13-14. Because petitioner had not really retired and the corporation was not "bona fide" for Social Security purposes, the court of appeals correctly determined that it was appropriate for the Commissioner to disregard the corporate structure and allocate undistributed corporate earnings to petitioner personally. *Id.* at 16.

2. Contrary to petitioner's claim (Pet. 8-10), the court of appeals' decision is consistent with decisions of the Sixth, Eighth, Tenth, and Eleventh Circuits. See *Johnson* v. *Chater*, 127 F.3d 756 (8th Cir. 1997); *Martin* v. *Sullivan*, *supra*; *Heer* v. *HHS*, *supra*; *Gardner* v. *Hall*, 366 F.2d 132 (10th Cir. 1966). All of those courts agree that the Commissioner may look past particular pay arrangements and corporate formalities where the evidence shows that the individual seeking retirement benefits structured the pay arrangements to circumvent the excess-earnings test.

The Eleventh Circuit's decision in *Martin* and the Sixth Circuit's decision in *Heer* specifically affirm the Commissioner's "right to examine the substance over the form" of all business pay arrangements. *Heer*, 670 F.2d at 655. In *Martin*, the Eleventh Circuit ruled that a wife's increased corporate salary could be imputed to her retired husband where the evidence showed that,

despite the salary shifting, the husband continued his pre-retirement work activities and the wife's duties remained unchanged. 894 F.2d at 1530. Because "the Secretary must be assured that the alleged retirement is legitimate, actual and bona fide," *id.* at 1532, the Eleventh Circuit sustained the Commissioner's disregard of the formal salary allocation.

In *Heer*, the plaintiff and his wife were the sole shareholders of a family corporation. 670 F.2d at 654. When the plaintiff allegedly "retired," there was an increase in his wife's salary with no attendant increase in her duties. *Ibid.* The Sixth Circuit, agreeing with SSA that the pay arrangement was fictitious, held that it was appropriate to reallocate part of the wife's income to the plaintiff. *Id.* at 655-656.

Although both *Martin* and *Heer* involved the shifting of payment between family members, the principle underlying the decisions is not so constrained. See *Martin*, 894 F.2d at 1532; *Heer*, 670 F.2d at 655. If the integrity of the Social Security retirement program is to be maintained, the Commissioner must be able to determine whether an applicant has really retired, and whether the salary paid for the applicant's services is in line with the labor market, as distinguished from a salary that is set merely to avoid the excess-earnings test. Pet. App. 15. Accordingly, neither *Martin* nor *Heer* conflicts with this case.

The Tenth Circuit's decision in *Gardner* and the Eighth Circuit's decision in *Johnson* likewise do not conflict with the decision below. In each case, the court recognized that the corporate veil or salary arrangement may be pierced in appropriate circumstances, *Johnson*, 127 F.3d at 759; *Gardner*, 336 F.2d at 135, and simply concluded that SSA had erred in doing so on the facts of the particular case. In *Gardner*, the Tenth

Circuit ruled that the Commissioner erred in allocating undistributed corporate profits to petitioner as wages because the corporation was a bona fide corporate entity. 366 F.2d at 135. The court explained that the "corporate entity must be respected" where evidence is lacking that the corporation is "a sham or a pretense." *Id.* at 135-136. Similarly, in *Johnson*, the Eighth Circuit reversed the Commissioner's allocation of undistributed corporate profits where there was no evidence that the corporation was a sham. 127 F.3d at 762.

The decisions in *Gardner* and *Johnson* rested on the ground that the corporation at issue was bona fide. In contrast, there is substantial evidence in this case to support the Commissioner's determination that petitioner's corporation was not bona fide (Pet. App. 16); indeed, petitioner presents no argument to the contrary. There accordingly is no conflict between the decision below and either *Gardner* or *Johnson*.

CONCLUSION

The petition for writ of certiorari should be denied.

Respectfully submitted.

SETH P. WAXMAN
Solicitor General
DAVID W. OGDEN
Acting Assistant Attorney General
JOHN HOYLE
CONSTANCE A. WYNN
Attorneys

MAY 1999